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# The Geopolitical Influence on Global Trade

## Summary

Geopolitics have been top of mind over the past few years as geopolitical developments have, at times, rattled financial markets and disrupted global economic activity. So far, geopolitical events have only caused temporary bouts of market volatility and activity disruptions; however, geopolitics may be causing structural changes to the way countries around the world interact with each other and, in turn, the functioning of the global economy. Not long ago, we published a series of reports focused on the intersection of geopolitics and deglobalization, and highlighted the possibility of a geopolitically induced fragmenting of the global economy. In this report, we explore whether opposing geopolitical ideologies are indeed influencing global trade patterns and if the hypothetical fragmentation is materializing.

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## An Update on the Intersection of Deglobalization and Geopolitics

Last year, we published a series of reports[1] [2] [3] focused on the state of globalization. The takeaway of those reports, in short, is that we believe the trend toward globalization has ended. And rather than a resurgence of economic cooperation between countries around the world, we believe deglobalization is more likely than re-globalization going forward. Geopolitics is at the heart of our view for further deglobalization. Over the past few years, the geopolitical landscape has materially worsened. Major military conflicts are active on two continents, while less systemic confrontations have popped up across South America, Africa and other parts of Europe and Asia. As far as the more significant conflicts, we have seen countries show explicit support for Ukraine following Russia's invasion, with others expressing solidarity with Russia. Similar dynamics unfolded after Hamas attacked Israel. Select countries have demonstrated unity with Israel, while others have adopted a more critical stance. These conflicts, in combination with other frictions, are creating global geopolitical fragmentation forces, where countries around the world are becoming more divided on geopolitical issues. In the same series of publications, we took that view a step further and noted that geopolitical fragmentation could lead to economic fragmentation, a scenario where countries with opposing geopolitical views at least partly sever economic linkages. Economic fragmentation is a risk to the long-term health of the global economy, especially as arguably the two most economically important countries—the United States and China—find themselves with opposing geopolitical perspectives, not only related to the Russia-Ukraine conflict and the war in the Middle East, but on many other geopolitical matters. With the U.S. and China the two largest economies in the world, and also possibly the most geopolitically influential, we outlined a hypothetical scenario where the U.S. and China cut economic linkages due to geopolitical differences, and countries around the world choose to align themselves with either the U.S. or China to show geopolitical solidarity. This aligning of nations ultimately fragments the global economy into two separate and distinct economic blocs—one led by the U.S. and the other by China.

We raised fragmentation as more of a tail-risk scenario; however, we also believed that the fragmentation scenario had momentum, especially as the global and U.S.-China geopolitical backdrops remained tense. But one angle we did not fully explore last year was whether geopolitical-induced fragmentation was already under way. We analyzed fragmentation from more of a hypothetical and theoretical perspective, but the question of whether trade is already fracturing along geopolitical lines remained outstanding. So, in an effort to address the lingering question of whether trade patterns have been, and/or still are, evolving along geopolitical philosophies, we updated our fragmentation framework for developments through the end of 2023 and also applied our framework to prior years. As far as the details of our framework, our analysis incorporates indicators that we believe may be predictive as to whether countries could choose to align themselves with the U.S. or China. In that sense, our framework includes voting alignment at the United Nations General Assembly (UNGA) —to what extent countries did or did not vote in unison with the U.S.—on all resolutions, but also UNGA voting patterns related to recent resolutions on Ukraine and Israel. Our framework also includes national security alliances and, more specifically, whether a country is affiliated with the U.S.-led NATO or Quad defense pact, or China's version known as the Shanghai Cooperation Organization (SCO). We also examine participation in the G7 Build Back Better World (B3W) infrastructure investment initiative and China's Belt & Road Initiative (BRI), as well as the strength of trade linkages to both the United States and China in an effort to gauge possible strategic allegiance from an economic perspective. Our framework then aggregates each of these variables to get a sense of how countries could potentially align. We also built our framework to identify countries that could opt for neutrality in a fragmented world (i.e., choose no alignment). Our framework identifies countries as neutral should they have no discernable voting pattern at the UNGA, are not associated with U.S. nor Chinese defense arrangements, do not participate in B3W nor BRI, and have no clear preference as far as trade relations. Figure 1 represents how each country leans on each indicator as well as overall strategic alignment as of 2023.

1 – The Rise of Deglobalization: Part 1

2 – The Rise of Deglobalization: Part 2, Geopolitics Are Dividing The World And Global Growth Is At Risk

3 – The Rise of Deglobalization: Part 3, Examining a Fragmented Global Economy With No Neutral Nations

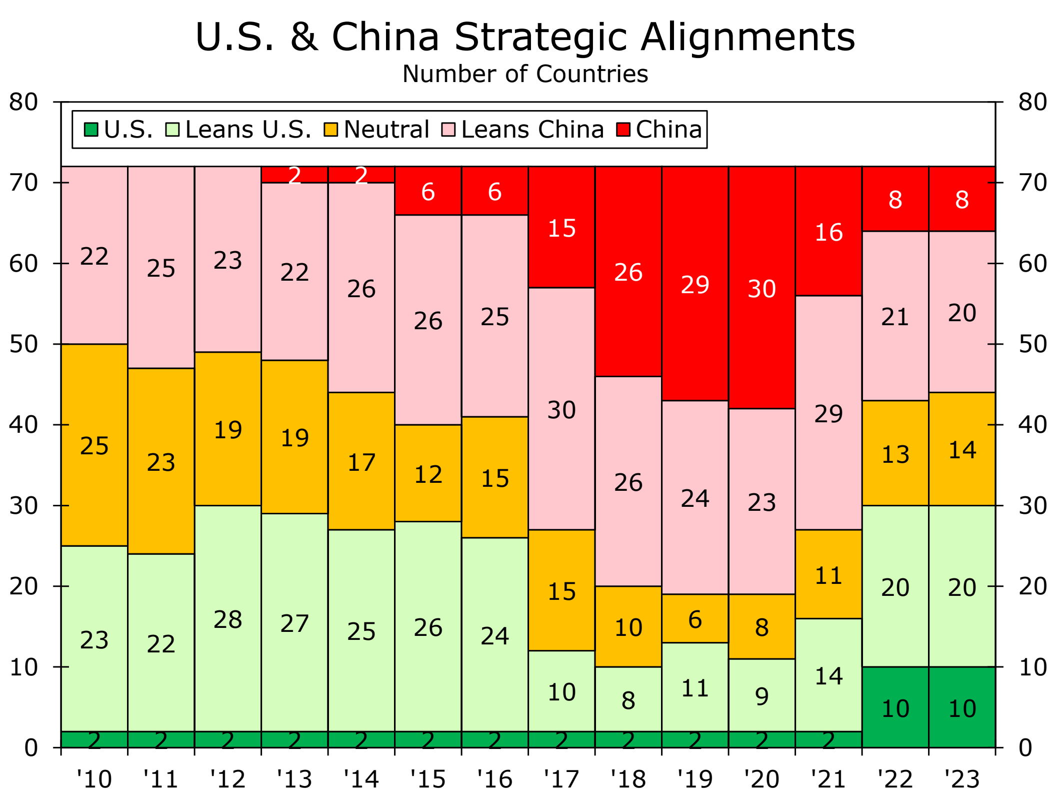
| | Overall Strategic Alignment: U.S. or China | UNGA Ukraine & Israel Related Voting Alignment (2022-Current) | United Nations General Assembly (UNGA) Voting Alignment | National Security Alliance (NATO/Quad or SCO) | Belt & Road Initiative or Build Back Better World | Trade Relationship U.S. vs. China (% of GDP) |
|---|---|---|---|---|---|---|
| **Canada** | U.S. | | | | | |
| **United Kingdom** | U.S. | | | | | |
| **European Union** | U.S. | | | | | |
| **Japan** | U.S. | | | | | |
| **Israel** | U.S. | | | | | |
| **Iceland** | U.S. | | | | | |
| **Norway** | U.S. | | | | | |
| **Switzerland** | U.S. | | | | | |
| **Colombia** | U.S. | | | | | |
| **Guatemala** | U.S. | | | | | |
| **Australia** | Leans U.S. | | | | | |
| **Mexico** | Leans U.S. | | | | | |
| **Honduras** | Leans U.S. | | | | | |
| **Turkey** | Leans U.S. | | | | | |
| **Argentina** | Leans U.S. | | | | | |
| **Costa Rica** | Leans U.S. | | | | | |
| **Dominican Republic** | Leans U.S. | | | | | |
| **South Korea** | Leans U.S. | | | | | |
| **Brazil** | Leans U.S. | | | | | |
| **New Zealand** | Leans U.S. | | | | | |
| **Philippines** | Leans U.S. | | | | | |
| **Ecuador** | Leans U.S. | | | | | |
| **Jamaica** | Leans U.S. | | | | | |
| **Jordan** | Leans U.S. | | | | | |
| **Bahrain** | Leans U.S. | | | | | |
| **Panama** | Leans U.S. | | | | | |
| **Paraguay** | Leans U.S. | | | | | |
| **Ukraine** | Leans U.S. | | | | | |
| **Morocco** | Leans U.S. | | | | | |
| **Egypt** | Leans U.S. | | | | | |
| **Thailand** | Neutral | | | | | |
| **El Salvador** | Neutral | | | | | |
| **India** | Neutral | | | | | |
| **Kenya** | Neutral | | | | | |
| **Kuwait** | Neutral | | | | | |
| **Nigeria** | Neutral | | | | | |
| **Peru** | Neutral | | | | | |
| **Qatar** | Neutral | | | | | |
| **Singapore** | Neutral | | | | | |
| **Tunisia** | Neutral | | | | | |
| **Uruguay** | Neutral | | | | | |
| **Bangladesh** | Neutral | | | | | |
| **Chile** | Neutral | | | | | |
| **Cambodia** | Neutral | | | | | |
| **Afghanistan** | Leans China | | | | | |
| **Malaysia** | Leans China | | | | | |
| **Tanzania** | Leans China | | | | | |
| **Oman** | Leans China | | | | | |
| **Saudi Arabia** | Leans China | | | | | |
| **United Arab Emirates** | Leans China | | | | | |
| **Pakistan** | Leans China | | | | | |
| **Nicaragua** | Leans China | | | | | |
| **Indonesia** | Leans China | | | | | |
| **Armenia** | Leans China | | | | | |
| **Vietnam** | Leans China | | | | | |
| **Algeria** | Leans China | | | | | |
| **Azerbaijan** | Leans China | | | | | |
| **South Africa** | Leans China | | | | | |
| **Sri Lanka** | Leans China | | | | | |
| **Venezuela** | Leans China | | | | | |
| **Bolivia** | Leans China | | | | | |
| **Turkmenistan** | Leans China | | | | | |
| **Uganda** | Leans China | | | | | |
| **Zimbabwe** | Leans China | | | | | |
| **Kazakhstan** | China | | | | | |
| **Russia** | China | | | | | |
| **Belarus** | China | | | | | |
| **Syria** | China | | | | | |
| **Kyrgyzstan** | China | | | | | |
| **Tajikistan** | China | | | | | |
| **Uzbekistan** | China | | | | | |
| **Iran** | China | | | | | |

Source: United Nations, NATO, CFR, Bloomberg Finance L.P. and Wells Fargo Economic

## Geopolitical Alignments Have Evolved Over Time

According to our framework, the number of countries in our sample that align to the U.S. and China was split relatively evenly at the end of last year. Ten countries strongly align to the U.S. and 20 lean toward the U.S., while eight strongly align to China and another 20 lean in China's direction. But our framework's output for 2023 represents only the most recent snapshot of how nations could potentially align. Allegiances can change as geopolitical developments unfold or evolve, while countries may also participate in certain investment programs. In that sense, we believe there is value in the evolution of our framework's output over time to show how allegiances may have changed. Figure 2 reveals our framework's country alignments from 2010-2023. The methodology we used to determine allegiances in 2023 is the same approach we used to determine possible alignments for each prior year. For context, we looked at UNGA voting alignments, trade relationships as well as membership to national security organizations for each year back to 2010. As far as participation in B3W and BRI, both programs did not kick off for some years later. In order to account for the timing mismatch, we labeled each nation as "neutral" for the B3W/BRI indictor until explicit country participation in either program began. Also, current conflicts in Ukraine and the Middle East did not start until recently; however, we inferred a sense of UNGA voting alignment based on historical resolutions such as votes tied to Russia's annexation of Crimea and special resolutions on Israel. Our framework's results show that alignments have indeed changed over the years. From 2010-2014, our framework's output was relatively steady as far as the number of nations aligning with the U.S. or China, as well as neutral nations. However, starting in 2015, and picking up notable pace from 2017-2020, nations seemingly made a more concerted pivot toward China. Shifts toward China, at least in the sense of our framework, are mostly driven by a significant amount of new countries participating in China's Belt & Road Initiative (BRI) and less coordination with the U.S. at the UNGA. As far as an overarching theme driving these decisions, our framework only captures changes in individual indicators; however, the pivot to China interestingly comes at a time when the U.S. policy landscape changed under the Trump administration. As foreign policy and trade policy became more uncertain, countries may have felt less inclined to align with the U.S. on increased policy unpredictability.

Figure 2



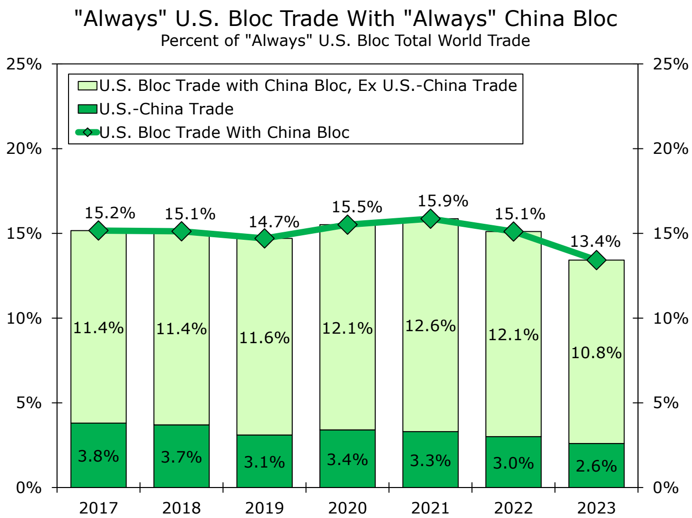

Source: United Nations, NATO, CFR, Bloomberg Finance L.P. and Wells Fargo Economics

However, over the past few years, our framework suggests nations are pivoting back toward the United States. Countries strongly aligned with China dipped sharply in 2021, and while the number of “leans China” countries rose, the number of overall China-aligned countries fell. The trend of fewer China-aligned nations continued in 2022, while U.S.-aligned countries jumped. In fact, 2022 marked something of an inflection point for alignment with the United States. Our framework suggests significantly more nations became strongly aligned to the U.S. in 2022, while the amount of “leans U.S.” nations climbed to the highest since 2016. Alignments were maintained in 2023 as last year saw little in the way of allegiance modifications. As far as the undertow pushing countries to the U.S., according to our framework, UNGA voting coordination is the driving force. Over the past few years, more countries have started voting in coordination with the United States in resolutions concerning the Ukraine and Israel/Gaza-related conflicts put forward at the UNGA. In addition, and while not the primary driver of the pivot toward the U.S., countries around the world have become slightly less dependent on China as a trade partner. Again, while our framework does not necessarily capture thematic justification for decisions such as voting alignment at the UNGA or a less robust trade relationship with China, multiple themes could have unfolded in recent years to drive the shift toward the U.S. and away from China. First, a sense of more policy predictability—especially on foreign relations and trade—in the U.S. under the Biden administration could potentially have resulted in countries looking to reengage with the United States. Also, the COVID pandemic sparked interest in supply chain diversification and corporations relocating operations out of China and into/closer to the United States. This nearshoring trend may be shifting trade relationships away from China in recent years. But most notably, Russia's invasion of Ukraine sparked a global effort to isolate Russia, both economically and geopolitically. China has demonstrated full support of Russia and continues to align itself geopolitically with Russia. As nations around the world isolate Russia, voting alignment at the UNGA, and broader geopolitical views, may be shifting back in favor of the United States.

## Are Geopolitics Impacting Trade Relationships?

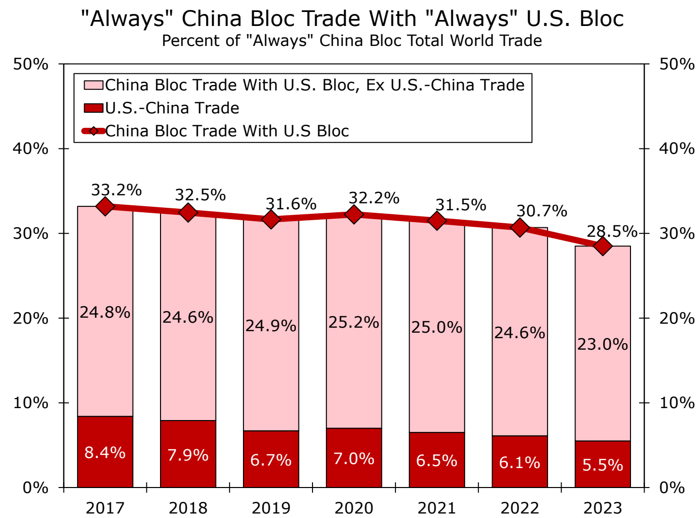
Now that our framework has determined country alignments by year over a period of time, we can dissect trade flows to see if there have been any changes in trade patterns between countries with opposing geopolitical ideologies. At this point, the exercise comes down to analyzing how annual trade between U.S.-aligned and China-aligned countries has evolved. Easier said than done as we worked though multiple iterations of how to analyze trade between geopolitical blocs. Our first iteration looked at trade assuming alignments as of the end of last year existed over the course of our analysis period. Interesting takeaways, but maintaining stagnant alignments does not capture shifting allegiances. We then analyzed trade between countries in each geopolitical bloc based on how countries aligned in each year. The results, while also interesting, are a little disjointed. Certain countries flip between a U.S. or China alignment multiple times, while others move in and out of neutral. As select nations move between segments, trade between geopolitical adversaries, on an annual basis, appears disorderly. So in an effort to diminish these types of challenges, we compromised on our methodology. Our final iteration looks at trade between countries that have *always* aligned to the United States or to China. More specifically, “alignment” refers to countries that have either strongly aligned or “lean” toward one country. For example, our framework suggests Canada has always strongly aligned or leaned toward an alignment with the United States. On the other hand, Russia identifies as always maintaining an allegiance to China. In this case, we would analyze annual trade between Canada and Russia, and look for any notable changes in the trade relationship over the years. We use Canada and Russia as examples. Our framework identifies 26 countries that always align with China and nine countries that always align with the United States, and we performed a similar analysis of looking at trade between those countries—including the United States and China. Ultimately, we aggregate trade between “always aligned” countries in rival geopolitical blocs and then calculate inter-bloc trade as a percent of each “always aligned” bloc's total trade with the world. Looking at this measure over time, inter-bloc trade as a percent of a given bloc's world trade tells us if nations in different blocs are more economically integrated with each other, or whether trade dependence is starting to lessen. If trade between countries that are “always aligned” to either the U.S. or China bloc trends lower, we can infer that geopolitical philosophy is an influence into selecting trading partners.

Figure 3




Source: Bloomberg Finance L.P. and Wells Fargo Economics

Figure 4




Source: Bloomberg Finance L.P. and Wells Fargo Economics

The final version of our analysis does indeed reveal that trade patterns are evolving along geopolitical lines. In fact, our analysis suggests geopolitical fault lines have been erected on trade for some time. To that point, the nations our framework identifies as always in the U.S. and China blocs have been trading less with each other since 2017. With only a modest disruption to that trend during the COVID years, always U.S.-aligned nations, including the U.S. itself, have become less trade-dependent on China and always China-aligned countries. In 2017, always U.S.-aligned nations traded goods worth 15.2% of the U.S. bloc's total world trade with China and China-aligned nations. Over time, trade linkages have dwindled, and as of 2023, always U.S.-aligned nations traded goods worth just 13.4% of the bloc's trade with the entire world with China and China-aligned countries, with the downtrend picking up pace in more recent years (Figure 3). Reduced trade dependencies also exist across the bloc, and we observe that less trade between the U.S. and China is not necessarily driving the overall trend. We mentioned earlier that the U.S. and China are slowly decoupling, which trade data indeed reveals; however, always U.S.-aligned and always China-aligned nations, excluding the U.S.-China trade relationship, are also trading less with each other. Trade between always U.S.- and China-aligned nations was worth 11.4% of the U.S. bloc's trade with the world in 2017. As of 2023, trade fell to just 10.8%. Similar dynamics exist for China and always China-aligned nations. In 2017, inter-bloc trade was worth 33.2% of the China bloc's world trade. In 2023, that number slipped to 28.5% (Figure 4). While reduced trade between the U.S. and China is driving softer trade relations between the two blocs, always China-aligned nations are also engaging less with always U.S.-aligned countries on trade as trade linkages have slipped from 24.8% of China bloc world trade to 23% at the end of last year.

Going forward, we will be keeping a close eye on the state of deglobalization and geopolitics, and how the two intersect with each other. As geopolitical risk remains elevated, scope for further deglobalization certainly exists, especially if already-active conflicts intensify and draw in new stakeholders. The entrance of new actors into any active military or geopolitical conflict introduces the possibility of shifting country-alignments, neutral nations eventually picking a side, and ultimately additional fragmentation forces. We will also keep an eye on the evolution of politics at local levels, particularly the U.S. election. Should U.S. trade policy turn more inward-looking, protectionist and defined by the imposition of tariffs, fragmentation and deglobalization could gather momentum in this scenario as well. In our prior reports, we noted that full geopolitical-led economic fragmentation can shave a good chunk off global GDP growth. As of now, we believe geopolitical-induced fragmentation is materializing, but is not necessarily our base case for how the global economy will evolve over the longer term. If fragmentation does gather momentum for any reason and becomes our base case, our view on the long-term prospects for the global economy would turn less constructive, possibly outright pessimistic.

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